

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayner
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Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of the Sale of Aquila, Inc.'s
Minnesota Assets to Minnesota Energy
Resources Corporation

ISSUE DATE: June 1, 2006

DOCKET NO. G-007,011/M-05-1676

ORDER APPROVING SALE SUBJECT TO
CONDITIONS

PROCEDURAL HISTORY

On October 17, 2005, Aquila, Inc. (Aquila) and WPS Minnesota Utilities, Inc. (WPS Minnesota) filed an Asset Purchase Agreement with the Commission (the Transaction).

On November 10, 2005, Cornerstone Energy, Inc. (Cornerstone) filed a petition to intervene and LSP-Cottage Grove (LSP) filed a Petition to Intervene and Comments on November 16, 2005.

On November 21, 2005, Aquila and WPS Minnesota (the Petitioners) filed joint reply comments.

On November 29, 2005, Aquila filed additional information.

On December 7, 2005, Hibbing Taconite Joint Venture (Hibtac), Mittal USA's Minorca Mine (Mittal), Northshore Mining Company (Northshore), United Taconite, LLC (UTAC), and the Minntac and Keewatin Mines of United States Steel Corporation (USS) (collectively, the Mining Companies) filed a petition to intervene.

On December 7, 2005, Aquila, WPS Minnesota, and Cornerstone filed a Protective Agreement and Order with the Commission.

On December 22, 2005, the Minnesota Department of Commerce (the Department) filed Comments recommending approval subject to conditions.

On January 3, 2006, Cornerstone and the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD/OAG) each filed comments.

On January 12, 2006, the Commission was formally notified that WPS Minnesota Utilities Inc. had changed its name to Minnesota Energy Resources Corporation (MERC).

On January 13, 2006, Minnesota Municipal Utilities Association (MMUA) filed a petition to intervene, the Petitioners filed Joint Reply Comments, and LSP-Cottage Grove filed reply Comments.

On January 25, 2006, the Petitioners filed a reply to MMUA and to LSP-Cottage Grove.

On February 2, 2006, MMUA filed Reply Comments.

On February 23, 2006, Aquila filed demand entitlement documents.

On March 6, 2006, the Petitioners filed an Amendment to their petition.

On March 10, 2006, the Department filed additional comments.

On March 15, 2006, a Stipulation and Agreement was filed by Cornerstone, MERC, a subsidiary of WPS Resources Corporation (WPSR), and Michigan Gas Utilities Corporation, also a subsidiary of WPSR.

On March 30, 2006, the Petitioners filed additional comments.

The Commission met on May 25, 2006 to consider this matter.

FINDINGS AND CONCLUSIONS

I. SUMMARY OF JOINT PETITION FOR APPROVAL

Aquila, Inc. (Aquila) and Minnesota Energy Resources Corporation (MERC)¹ are jointly requesting that the Commission approve the sale of the Minnesota assets of Aquila's two divisions, Aquila Networks-PNG and Aquila Networks-NMU, to MERC pursuant to the Asset Purchase Agreement dated September 21, 2005, by and between Aquila and WPS Minnesota.

The Petitioners' request is subject to Commission review and approval pursuant to Minn. Stat. § 216B.50 and Minn. Rules, Part 7825.1800, which requires the Commission to find that the proposed transaction is consistent with the public interest before granting approval.

¹ The initial petition for approval was filed by Aquila and WPS Minnesota Utilities. Subsequently, WPS Minnesota Utilities changed its name to Minnesota Energy Resources Corporation (MERC). The term Petitioners in this Order refers to Aquila and MERC.

The proposed transaction is a significant regulatory event because the purchase price is approximately \$288 million, making this a relatively large asset sale. In addition, Aquila is a major provider of natural gas distribution service in Minnesota, serving approximately 200,000 Minnesota customers, who would now be served by MERC.

II. PRELIMINARY MATTERS — PETITIONS TO INTERVENE

A. Cornerstone's Petition to Intervene

Cornerstone stated that as a large customer of Aquila, a potential customer of WPS-Minnesota (now MERC), and a natural gas supplier to many of the largest customers and largest employers in what would be WPS-Minnesota's service territory, Cornerstone brings a unique perspective regarding issues of interest to large customers.

The Petitioners stated that, with reservations, they did not object to Cornerstone's Intervention, but requested that in granting Cornerstone's Petition, the Commission make it clear that Cornerstone's participation will be limited to addressing legitimate ratepayer interests.

On March 15, 2006, the Commission received a Stipulation and Agreement between Cornerstone, MERC, and Michigan Gas Utilities Corporation. The parties represented that the Stipulation and Agreement fully resolved Cornerstone's issues in the matter and that Cornerstone withdraws its opposition to the Asset Purchase Agreement.

The Commission interprets the Stipulation as effectively withdrawing Cornerstone's petition to intervene.

B. LSP's Petition to Intervene

LSP argued that its intervention is in the public interest and that it should be allowed to intervene in this proceeding with full rights as a party because its interests are directly implicated within the meaning of Minn. Rules, Part 7829.0800. In support of its petition, LSP noted that it is unclear whether in exiting Minnesota Aquila is assigning Aquila's Gas Supply Transportation Agreement with LSP to MERC. LSP stated that it has a vital interest in ensuring that the proposed transfer does not adversely impact or denigrate the services that its Cottage Grove Facility is entitled to receive under the Agreement.

No one, including the Commission, has objected to LSP's Petition to Intervene. Accordingly, the petition was not suspended and is considered granted as a matter of law under Minn. Rules, Part 7829.0800, subp. 5.

C. The Mining Companies' Petition to Intervene

The Mining Companies sought to intervene in this proceeding in order to verify and confirm that the proposed transfer will not adversely impact existing services provided to them under the terms of the tariff and their individual agreements with Aquila. These customers asserted that their interests in this matter are sufficiently unique that these interests may not be

adequately addressed by other parties to this proceeding. They added that their participation in this matter will not disadvantage or burden any other party.

No objections to the Mining Companies' Petition to Intervene were filed, nor has the Commission on its own motion objected. The Mining Companies' petition therefore was not suspended and is considered granted pursuant to Minn. Rules, Part 7829.0800 subp. 5.

D. Minnesota Municipal Utilities Association's (MMUA's) Petition to Intervene

MMUA argued that it has a peculiar interest, distinct from the general public, in this proceeding. MMUA members include municipal utilities operating gas and/or electric utilities, as well as municipalities.

The Petitioners recommended that the Commission deny MMUA's request to intervene. The Petitioners claimed that MMUA's petition is untimely and that Aquila does not provide wholesale natural gas service to any municipal gas utility or any natural gas service within the boundaries of any municipality operating a municipal gas utility.

In response, MMUA argued that Aquila is incorrect in claiming that no Minnesota municipalities, cities, or their citizens will be affected by the sale since the proposed sale includes and would affect 47 Minnesota municipal utilities and 168 Minnesota cities and townships. MMUA noted that Aquila has not cited any statute or Commission order deadline that MMUA has exceeded to make the filing untimely, nor has it shown that the timing of the MMUA filing will prejudice any of the parties. MMUA stated that Aquila's opposition to its petition to intervene was itself untimely since it was filed more than 10 days after MMUA's petition, in violation of Minn. Rules, Part 7829.0800, subp. 4.

At the hearing on this matter, Aquila reported that subsequent to the filed positions of the parties (MMUA and Aquila) on this issue, MMUA clarified that it did not seek a contested case proceeding in this case and consequently, Aquila stated, it withdrew its objection to MMUA's petition to intervene.

The Commission finds that MMUA's initial petition was timely filed and that, upon the withdrawal of Aquila's objection, MMUA's petition to intervene is approved. Further, since Aquila has withdrawn its objection, the Commission need not address MMUA's assertion that Aquila's objection was untimely.

III. PRELIMINARY MATTERS — FILING REQUIREMENTS

The filing requirements applicable to petitions for approval of transfers or sales of assets are set forth in Minn. Rules, Part 7825.1800, Subpart B, which requires the filing of items identified in Minn. Rules, Part 7825.1400, items A to J.

The Petitioners have filed more information than is required for a proposed sale or transfer of

assets and instead have provided the level of information required for a merger. To illustrate:

Filing Requirements for a Sale or Transfer of Assets	Filing Requirements for a Merger
all information as required in part 7825.1400, items A to J; the agreed upon purchase price and the terms for payment and other considerations.	the petition signed by all parties; all information, for each public utility, as required in parts 7825.1400 and 7825.1500; the detailed reasons of the petitions and each party for entering into the proposed transaction, and all facts warranting the same; the full terms and conditions of the proposed merger or consolidation.

The Petitioners requested a variance from Minn. Rules, Part 7825.1400, subpart J, which is a requirement for a proposed sale or transfer of assets. Subpart J requires a balance sheet, income statement, and statement of changes in financial position no earlier than six months prior to the date of the petition.

In support of its variance request, the Petitioners argued that it would be unduly burdensome for Petitioners to provide mid-year (June 30, 2005) financial data. Since PNG and NMU do not prepare mid-year financial reports, the data used to prepare such financial statements would need to be created and would be based upon unaudited information. The Petitioners noted that the fiscal year-end 2004 data for PNG and NMU was filed to comply with the rule. The Petitioners also stated that granting the variance would not harm the public interest because 2004 information is fully adequate to make a determination of the reasonableness of the Transaction. They also stated that granting the variance would not conflict with standards imposed by law.

The Commission will grant the requested variance. The Commission does so because it finds that the request meets the standards established in Minn. Rules, Part 7829.3200, subpart 1 for granting variances: 1) enforcement of the requirement would impose an excessive burden upon the Petitioners; 2) granting the variance will not adversely affect the public interest; and 3) granting the variance will not conflict with standards imposed by law.

The Commission further concludes, based on the Department's review and recommendation and the Commission's own review, that with the variance, the Petitioners have substantially complied with the requirements of Minn. Rules, Part 7825.1800.

IV. SUMMARY OF THE COMMISSION'S ANALYSIS AND ACTION ON THE MERITS OF THE PETITIONERS' PROPOSED TRANSFER/SALE OF ASSETS

The Commission has investigated this matter as required by Minn. Stat. § 216B.50, duly noticed and received oral argument from interested parties, and reviewed all filings herein. The Commission finds that benefits of the sale include: assurance that MERC will delay a request for a general rate increase at least longer than Aquila would have, the fact that MERC's lower cost of capital will benefit ratepayers in future rate cases, and the fact that MERC's management experience and financial stability compare favorably.

Based on the record established herein, the Commission concludes that the sale of Aquila's Minnesota utility properties to Minnesota Energy Resources Corp as detailed in the Petition is consistent with the public interest under certain conditions detailed in Section V of this Order. Accordingly, the Commission will approve the Petition subject to the conditions discussed below in Section V and listed in Order Paragraph 3, items 1 - 9.

V. CONDITIONS

A. Recovery of Acquisition Premium and Transaction Costs Precluded

The Petitioners stated that the purchase price of \$288 million is subject to post-closing adjustments which will include adjustments for working capital. Because the purchase price exceeds the book value of the assets being sold, an acquisition adjustment will be recorded at closing.

The Department and the RUD-OAG argued that if an acquisition adjustment, transaction and transition costs are passed on to ratepayers in MERC's first general rate case, the proposed sale may not be consistent with the public interest. They stated that sale-related acquisition adjustment, transaction and transition costs may outweigh any benefits from the sale causing ratepayers to pay for costs that provide no additional benefit. In order to keep ratepayers from the harm of higher costs related to the proposed sale, the Department and the RUD-OAG recommended that the Commission deny recovery of any sale related acquisition premium, transition costs, and transaction costs.

The RUD-OAG asserted that the Commission has consistently held that a company's shareholders, and not its ratepayers, should bear the costs associated with an acquisition adjustment as an appropriate and necessary condition for approval of the proposed sale. The RUD-OAG cited several Commission Orders for that proposition.²

² *In the Matter of the Joint Petition of Centel Corp., Central Tel. Co., Rochester Tel. Corp. and Vista Telephone Company of Minnesota for Approval of Transfer of Telephone Operations and Authority to Provide Telephone Service*, Docket No. H-2028, P-405-/PA-91-130, ORDER APPROVING TRANSFER OF OPERATIONS AND AUTHORITY (June 26, 1991) at

As one of the conditions that will, together with all the others listed in this Section, render the Petitioners' transaction consistent with the public interest, the Commission will preclude MERC from recovering the acquisition premium and transaction costs associated with MERC's purchase of Aquila's Minnesota assets. The Commission clarifies that recovery of transition costs are not denied at this time. In a future rate case, MERC may propose recovery of transition costs and seek to justify recovery of those costs.

B. Final Accounting Entries

The Department recommended that if the sale is approved, the Commission should require the final accounting entries related to the Transaction be submitted within 20 days of closing the sale.

The Petitioners agreed with the need to file the final accounting entries, but requested a modification of the time to make a filing. The Agreement contemplates that a purchase price adjustment will be made after closing. Aquila has 90 days after the closing to deliver an adjustment statement and Energy Resources is allowed 30 days for review of the restated adjustment. If there is a disagreement on the purchase price adjustment, additional time may be necessary. To address this issue, the petitioners proposed the following language:

Require the final accounting entries related to the Transaction be filed within 20 days after the final determination of any purchase price adjustment.

The Commission finds that the Petitioners' modification of the Department's recommendation is reasonable and that the proposed language is appropriate. As a condition of finding the proposed sale consistent with the public interest, the Commission will so Order.

4; *In the Matter of the Joint Petition of Citizens Utilities Company and GTE Corporation for Approval of Citizens' Acquisition of GTE Telephone Properties*, ORDER APPROVING SALE, GRANTING ETC STATUS, AND ISSUING CERTIFICATE OF AUTHORITY AND REQUIRING FILINGS, Docket No. P-5316,407/PA-99-1239, (July 24, 2000) at 5; *In the Matter of the Joint Petition by Minnegasco for Approval of the Transaction Pursuant to the Agreement and Plan of Merger*, Docket No. G-008/PA-96-950 at 2, 7, ORDER APPROVING MERGER SUBJECT TO CONDITIONS (February 24, 1997); *In the Matter of as Petition by Northern Minnesota Utilities for Approval of a Proposed Acquisition of Natural Gas Distribution Facilities From the City of Warroad, Minnesota.*, Docket No. G-007/PA-92-348, ORDER GRANTING APPROVAL OF ACQUISITION AND OF INCREASE IN ENTITLEMENTS (July 20, 1992) at 3; *In the Matter of a Proposed Merger of Minnegasco, Inc. With and Into Ark-la, Inc.*, Docket No. G-008/PA-90-604, ORDER APPROVING MERGER AND ADOPTING AMENDED STIPULATION WITH MODIFICATIONS (November 27, 1990) at 6.

C. Conformance With Commission Policies, Procedures, and Orders Regarding Cost Allocations

In their initial filing, the Petitioners committed that with respect to the unregulated Service Guard business, WPS Minnesota [now MERC] would conform to the Commission's procedures and filing requirements for allocation of costs between regulated and non-regulated activities set forth in Docket No. G,E-999/CI-90-1008.

The Department commented that this statement appeared to exclude all of WPSR's [MERC's parent company's] other non-regulated businesses besides Service Guard. The Department stated that to protect ratepayers, the Commission should put WPS Minnesota [now MERC] on notice that in its future general rate cases the Company must conform to the Commission's procedures and filing requirements for allocation of costs for all WPSR's nonregulated activities, not just Service Guard.

In Reply Comments, MERC agreed that it must comply with the standards established by the Commission with respect to all WPSR nonregulated activities as well as Service Guard. To eliminate later dispute, Energy Resources requested that the condition be rephrased as follows:

Energy Resources is required in its future general rate cases to comply with accounting standards established by the Commission in its September 28, 1994 Order in Docket No. G,E-999/CI-90-1008.

To provide the comprehensive clarifying notice that the Department appropriately recommends, the Commission will put MERC on notice that in its future general rate cases it must conform to the Commission's policies and procedures and filing requirements for allocation of costs for all WPSR's nonregulated activities as well as Service Guard and shall comply with accounting standards established by the Commission in its September 28, 1994 Order in Docket No. G,E-999/CI-90-1008.

D. Customer Notice

In their initial filing, Aquila and WPS Minnesota [now MERC] proposed to notify customers of the change in service providers through a Commission approved customer notice after the transfer.

The Department recommended that, to protect ratepayers the Commission should require Petitioners to file for review by Commission Staff and the Department a proposed customer notice within 10 days of closing the Transaction. The Petitioners agreed to file a proposed customer notice within 10 days of closing the transaction.

The Commission finds the Department's recommendation reasonable and will adopt it. As a condition of finding the proposed sale consistent with the public interest, Petitioners will be required to file a proposed customer notice within 10 days of closing the Transaction for review by Commission Staff and the Department.

E. Revised Tariffs

The Department noted that the Petitioners stated that WPS Minnesota [now MERC] will sell and offer to sell natural gas service in the transferred service areas pursuant to the same rates, terms and conditions as set forth in Aquila's current tariff and that the name of WPS Minnesota [now MERC] may be changed and/or it may operate under a different name in Minnesota. To keep the tariff updated, the Department recommended that the Commission require that the Petitioners file revised tariffs with the new company name(s) within 30 days of closing the Transaction and within 30 days of any name change in the future. The Petitioners did not object to that recommendation.

The Commission finds the Department's recommendation is reasonable and will adopt it. As a condition of finding the proposed sale consistent with the public interest, Petitioners will be required to file revised tariffs with the new company name(s) within 30 days of closing the Transaction and within 30 days of any name change in the future.

F. Post-Sale Reserve Margin

The Petitioners reported that MERC's post-sale demand entitlement reserve margin would increase from the pre-sale reserve margin of 5.04 percent for the combined areas (the area currently served by Aquila Networks -PNG and the area currently served by Aquila Networks-NMU) to 11.43 percent.

The Department noted that the estimated reserve margin of 11.43 percent is higher than the 2004-2005 heating season average Minnesota gas utility reserve margin of 3.29 percent. The Department stated that although the majority of the firm transportation contracts expire in 2007, it anticipated that MERC would work towards a reserve margin in the five to seven percent range. To monitor progress towards that reserve margin, the Department recommended that the Commission require MERC to report, in its 2006 demand entitlement filings, the measures taken to lower the reserve margin after the sale.

The Commission finds that the Department's recommendation is reasonable. As a condition of finding the proposed sale consistent with the public interest, MERC will be required to report, in its 2006 demand entitlement filings, the measures taken to lower the reserve margin after the sale.

G. Service Quality Standards and Reporting

The Petitioners claimed that the transaction would not significantly change or adversely affect the provision of service to Minnesota customers for the following reasons.

First, while Aquila intended to file a general rate case seeking an increase in rates during 2005, MERC does not plan to file an immediate general rate case. Second, MERC will assume Aquila's existing rates and tariffs. Third, MERC will continue delivering services through divisions organized as PNG and NMU. Fourth, no layoffs are planned. Fifth, pursuant to the Asset Purchase Agreement, MERC will take assignment of Aquila's transportation, storage, gas supply and related contracts as necessary to ensure reliable service to Minnesota customers.

In addition, the Petitioners stated, WPSR's other public utilities have a strong record of performance and WPSC's performance metrics are comparable to the Service Quality Standards reported by Aquila in Docket No. G-007, 011/CI-02-1369. Petitioners stated that WPSC's customer service scores, as measured by J.D. Power and Associates' 2005 Gas Utility Residential Customer Satisfaction Study, exceeded the Midwest averages for gas utilities, ranking fifth out of 20 utilities.

Nevertheless, the Department expressed concern lest Minnesota ratepayers be harmed by a potential deterioration of service after the transaction. The Department stated that it will review WPS Minnesota's (now MERC's) future quarterly Service Quality Standards reports to ensure that service to Minnesota ratepayers does not decline.

The Commission shares the Department's concern to safeguard the ratepayers in this regard and will therefore condition finding the proposed sale consistent with the public interest on MERC's agreement to comply with the service quality standards and reporting previously established for Aquila. As a further ratepayer safeguard, the Commission clarifies that the compliance with the service quality standards and reporting previously established for Aquila include the standards Aquila agreed to on May 4, 2006 as reflected in the Commission's May 16, 2006 Order in Docket No. G-007,011/CI-02-1369.³ In short, the Commission will require that MERC, as Aquila's successor, be responsible for ensuring that customer service quality meets the standards established by Minnesota Law and this Commission.

VI. CONDITION DISCUSSED BUT NOT IMPOSED

A. Kansas Storage Property Tax

The Petitioners stated that after the sale MERC will be subject to the Kansas Storage Property Tax on the holding storage capacity located in Kansas that it receives from Aquila on Northern Natural Gas pipeline. It is anticipated that this tax will total approximately \$300,000 to \$400,000 per year and that MERC may seek to recover that amount through the PGA. In response to a Department inquiry, MERC assured that it will not seek retroactive recovery of any Kansas Storage Property Tax paid by Aquila prior to the sale.

³ See *In the Matter of an Inquiry into the Possible Effects of the Financial Difficulties at Aquila, Inc. on Peoples Natural Gas Company and Northern Minnesota Utilities Company and Their Customers*, Docket No. G-007,011/CI-02-1369, ORDER ACCEPTING QUARTERLY SERVICE QUALITY REPORTS FOR 2005 AND REQUIRING ADDITIONAL INFORMATION (May 16, 2006). The Order requires, in part, that in future service quality reports, Aquila shall 1) include information about service interruptions caused by system integrity failures, filed in a specific format, and 2) provide as part of its future service quality reports copies of its emergency response reports submitted to the Minnesota Office of Pipeline Safety.

The Commission will not address the merits of this issue in this Order. It is unclear from the record established in this matter whether the tax in question is in fact already being recovered through the Company's Minnesota rates. Moreover, it is not necessary for the Commission to decide this issue to approve the proposed sale and the issue is not ripe for decision since MERC is not seeking approval for PGA recovery of any Kansas Storage Property Tax payments. The Commission can review the appropriateness of any PGA recovery of Kansas Storage Property Tax payments when and if MERC requests approval for such recovery.

B. Insulating Regulated Assets From Cross-Collateralization

The RUD-OAG noted that the closing date of the transaction in question (no earlier than February 8, 2006) coincided with the repeal of the federal Public Utilities Holding Company Act of 1935 (PUHCA of 1935) and its holding company restrictions. The 2005 PUHCA requires the Federal Energy Regulatory Commission (FERC) to issue new rules, but FERC's recently issued rules do not provide the protections afforded under the 1935 PUHCA. The RUD-OAG asserted that the Petitioners selected the closing date (no earlier than February 8, 2006) to avoid the constraints of the 1935 PUHCA.

The RUD-OAG stated that with the repeal of PUHCA 1935 and replacement with the federal Energy Policy Act of 2005, states have the option to adopt ring-fencing provisions⁴ on the state level and noted that Wisconsin has its own Wisconsin Utilities Holding Company Act (WUHCA) which contains provisions similar to the 1935 PUHCA.⁵ The RUD-OAG urged the Commission to require MERC to stipulate that it will adhere to the WUCHA ring-fencing provisions with respect to its activities in Minnesota to insulate MERC's regulated assets in Minnesota from cross-collateralization with unregulated assets, as well as to provide other protections afforded by the WUCHA.

⁴ In brief, ring-fencing provisions seek to insulate regulated assets from cross-collateralization of the Petitioners' transaction. The term ring-fencing applies to provisions that 1) limit the geographic spread of utility holding companies, the kind of businesses they could engage in, the number of layers of holding companies above a public utility in a corporate hierarchy, and their capital structure; 2) control the amount of debt (and thus, the cost of capital), dividends, loans, and guarantees based on utility subsidiaries (hindering the parent companies from equity stripping or bankrupting the utility subsidiary), 3) control the securities that parent companies could issue; 4) regulate self-dealing among affiliate companies and cross-subsidization of unregulated businesses by regulated businesses; 5) control acquisitions of other utilities and other businesses; and 6) limit common ownership of both electric and natural gas utilities. The 1935 PUHCA also limited the activities (and campaign contributions) of officers and directors of holding companies who had control over the holding companies' accounts, books and records.

⁵ Wis. Stat. § 196.795.

The Petitioners replied that the OAG's request that MERC adhere to WUHCA ring-fencing provision with respect to its activities in Minnesota is overly broad, vague, and creates potential conflicts with Minnesota state law. They argued that it would be inappropriate for the Commission to require MERC to operate under the laws of another state.

The Petitioners stated that WPSR, MERC's Wisconsin-based parent, will comply with WUHCA as well as all other applicable Wisconsin laws in Wisconsin, and MERC will comply with all applicable Minnesota laws in Minnesota. Beyond supplying that stipulation, they stated, the OAG's request is inappropriate. At the hearing, Petitioners argued that the provisions of the WUCHA raised public policy issues that should be properly addressed only by the Minnesota legislature or by the Commission in a rule-making or other industry-wide generic proceeding.

At the hearing, the Department stated that the Department did not need the ring-fencing provisions of the WUCHA to identify any cost misallocations by MERC and to bring them to the Commission's attention for correction in MERC's next rate case.

The Commission will not require MERC to comply with the Wisconsin statute. Ring-fencing provisions appear more appropriately addressed by the legislature or by the Commission in a rulemaking or generic docket where issues of need and reasonableness can be fully examined by all affected parties.

C. Rate Freeze

The RUD-OAG proposed a rate freeze to offset/prevent harm to ratepayers that it said would result from the proposed sale.

The RUD-OAG explained the ratepayer harm it foresaw as follows. Aquila's deferred taxes (taxes recovered from ratepayers but not remitted to the Internal Revenue Service) cannot be transferred with the assets being sold to MERC, according to IRS regulations. The RUD-OAG stated that since a utility must subtract deferred taxes from rate base when applying for a rate increase any loss of deferred taxes will automatically increase a utility's rate base causing ratepayers' rates to increase.

As a consequence, the RUD-OAG argued, the sale of Aquila's assets to MERC will result in loss of tax benefits, thereby increasing the buyer's (MERC's) rate base and causing ratepayers' rates to increase. The RUD-OAG recommended that the Commission determine the magnitude of the lost tax benefits to ratepayers and, based on that, determine the length of the rate freeze that will be required to prevent harm to ratepayers from the proposed sale. The RUD-OAG cited instances in which the Commission had ordered rate freezes.

The Petitioners acknowledged that federal law prohibits the transfer of Aquila's deferred income tax liabilities to MERC and that this prohibition has the effect of raising the rate base. The Petitioners denied, however, that this isolated fact makes a rate freeze in the public interest. The Petitioners noted that during the twenty years the federal prohibition cited by the RUD-OAG has

been in existence, the Commission has never required a utility or telephone company to forgo an otherwise appropriate rate increase.

The Petitioners also stated that the cases cited by the RUD-OAG were not relevant because they were cases involving mergers where significant reductions in the cost of service would occur. The Petitioners stated that where merger synergies exist, it may be reasonable for a utility to consent to a rate freeze, but the transaction in this matter is an asset sale, not a merger, and the types of savings that can occur in a merger are not present.

The Petitioners alleged that the financial facts of this case do not support a rate freeze and that the immediate ratepayer benefits of the sale outweigh the one offsetting cost identified by the RUD-OAG. The ratepayer benefits cited by the Petitioners included avoiding Aquila's request for a significant rate increase and the fact that MERC's lower cost of capital will benefit ratepayers in future rate cases.

The Commission will not impose a rate freeze on MERC. The financial facts established in this case do not support a rate freeze. Cost savings that could potentially justify a rate freeze have not been projected. In these circumstances, the Commission concludes that imposing a rate freeze could potentially require MERC to earn less than a reasonable return on its investment. In lieu of a freeze, the Commission notes that MERC has committed to delay filing a general rate case longer than Aquila would have. The Commission concludes that it is premature to determine whether MERC's rate should remain unchanged (rate freeze) and will review that question in the context of MERC's next rate case where the Company will have the burden to show the reasonableness of any proposed rate increase.

D. Baselines for Cost Allocations

At the hearing on this matter, there was discussion regarding the desirability and substance of Commission guidance regarding corporate cost allocations. The Commission finds that there is insufficient record to make a decision on this subject at this time. At the same time, it seems appropriate that the Commission and MERC have at least some general point of departure for analysis of corporate cost allocations in the next rate case.

The Commission will therefore direct Aquila, MERC, and the Department to work together to establish baselines for the cost allocations appropriate for the next rate case.

ORDER

1. The petitions to intervene in this matter filed by Cornerstone, LSP, the Mining Companies, and MMUA are granted as discussed in the text of this Order.
2. The Commission hereby grants the Petitioners a variance from Minn. Rules, Part 7825.1400, subpart J, accepts the fiscal year-end 2004 data as compliance with the

rule, and finds that the Petitioners have substantially complied with the filing requirements of Minn. Rule 7825.1800.

3. The Commission determines that the sale of Aquila's Minnesota utility properties to Minnesota Energy Resources Corp (MERC) as detailed in the Petition (the Transaction) is consistent with the public interest under certain conditions and approves the Petition subject to the following conditions:
 - 1) Recovery of any sale-related acquisition premium and transaction costs is denied. Recovery of transition costs is not denied and may be sought in a future rate case.
 - 2) Within 20 days after the final determination of any purchase price adjustment, MERC shall file final accounting entries related to the Transaction.
 - 3) MERC is hereby put on notice that in its future general rate cases it must conform to the Commission's policies and procedures and filing requirements for allocation of costs for all WPSR's nonregulated activities as well as Service Guard and shall comply with accounting standards established by the Commission in its September 28, 1994 Order in Docket No. G,E-999/CI-90-1008.
 - 4) Within 10 days of closing the Transaction, Petitioners shall file a proposed customer notice for review by Commission Staff and the Department.
 - 5) Within 30 days of closing the Transaction and within 30 days of any name change in the future, Petitioners shall file revised tariffs with the new company name(s).
 - 6) In its 2006 demand entitlement filing, MERC shall report the measures taken to lower the reserve margin after the sale.
 - 7) MERC shall comply with the service quality standards, and reporting, established for Aquila, including standards Aquila agreed to on May 4, 2006, as reflected in the Commission's May 16, 2006 Order in Docket No. G-007,011/CI-02-1369.
 - 8) MERC shall ensure that customer service quality meets the standards established by Minnesota Law and this Commission.
 - 9) Aquila and MERC shall work with the Department to establish baselines for the cost allocations appropriate for the next rate case.
4. The Stipulation and Agreement between Cornerstone, MERC, and Michigan Gas Utilities Corporation filed March 15, 2006 is incorporated into this Order. The parties thereto shall abide by its terms.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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